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NEW VENTURE DIVERSIFICATION AND FAILURE IN THE MICROFINANCE INDUSTRY (INTERACTIVE PAPER)

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≈ INTERACTIVE PAPER ≈

**NEW VENTURE DIVERSIFICATION AND FAILURE
IN THE MICROFINANCE INDUSTRY**

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Principal Topic

We investigate the relationship between diversification and risk of firm failure for new ventures. In doing so, we draw upon two streams of research. First, based on related diversification literature we hypothesize that competing in multiple product-markets from inception lowers the risk of firm failure. However we also formulate a competing hypothesis based on the simplicity literature (Lumpkin & Dess, 1995; Miller, 1983). This literature argues that simplicity and focus in the strategy-making process within new ventures is positively linked to performance (Lumpkin & Dess, 1995). We extend this logic to product-market diversification and hypothesize that competing in multiple product-markets from inception increases the risk of firm failure. Lastly, we combine the related diversification and simplicity literatures to hypothesize that firms which diversify after inception have a lower risk of failure than firms which are diversified at inception.

Method

Our sample is comprised of microfinance organizations around the world founded since 1997. The data were largely derived from the public records of the Microfinance Information Exchange (MIX). We selected all microfinance institutions reporting to MIX for which data was available from the first year of operations. Firms were coded as born diversified if they engaged in both microlending and microsaving services in the first year of operations, whereas firms were coded as not born diversified if they only engaged in microlending services. We then tracked and coded their operating status (i.e. whether or not they ceased operations) each year through 2011. Our final sample is composed of 431 microfinance institution and 2,337 firm-year observations. Cox proportional hazard modeling is utilized to test our hypotheses.

Results and Implications

Our results indicate that born diversified firms are 125% more likely to fail than firms which begin with a single line of business. Furthermore, firms which diversified later were 73% less likely to fail than their born diversified counterparts. These large percentages lend weight to the potential impact of diversification within new ventures. These results contribute to diversification, entrepreneurship, and strategic entrepreneurship literatures, and may help guide entrepreneurs in establishing the scope of their new ventures.

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